A STUDY OF

CORPORATE GOVERNANCE IN PAPER INDUSTRY

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SYNOPSIS

The management or governance is the main function of the board of directors. Ultimately, the quest for better management rests with this governing body. But, unfortunately the BODs of corporate bodies in most of the cases have no clear cut idea of management of their corporate. Ultimately, in result they are leading to failure in corporate or economic front of the industry or nation. Corporate bodies are putting their efforts for better management or good governance of their entities. The scenario of best management practices or good governance emerged as a result of this search. In this direction Corporate Governance best equips corporate bodies with certain guidelines, principles and best practices in managing corporate bodies.

The Concept:

Corporate governance is most often viewed as both the structure and the relationships which determine corporate direction and performance. The board of directors is typically central to corporate governance. Its relationship to the other primary participants, typically shareholders and management, is critical. Additional participants include employees, customers, suppliers, and creditors. The corporate governance framework also depends on the legal, regulatory, institutional and ethical environment of the community. Whereas the 20th century might be viewed as the age of management, the early 21st century is predicted to be more focused on governance. Both terms address control of corporations but governance has always required an examination of underlying purpose and legitimacy – James McRitchie (1999).

Corporate governance is a field in economics that investigates how to secure / motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate

that the corporate managers will deliver a competitive rate of return Mathiesen (2002). Sir Adrain Cadbury (1992) defined Corporate Governance as “the system by which companies are directed and controlled.”

Sir Adrian Cadbury (2004) lamented "Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society". In the words of Demb and Neubauer (1992) “Corporate Governance is a process by which corporations are made responsive to the rights and wishes of stakeholders.

As per Simon Deakin Monks Corporate governance is about how companies are directed and controlled. Good governance is an essential ingredient in corporate success and sustainable economic growth. Research in governance requires an interdisciplinary analysis, drawing above all on economics and law, and a close understanding of modern business practice of the kind which comes from detailed empirical studies in a range of national systems.

As per Shann Turnbull (1998) Corporate governance describes all the influences affecting the institutional processes, including those for appointing the controllers and/or regulators, involved in organizing the production and sale of goods and services. Described in this way, corporate governance includes all types of firms whether or not they are incorporated under civil law. According to Monks and Minow (1995) corporate governance is the relationship among various participants [chief executive officer, management, shareholders, employees] in determining the direction and performance of corporations".

In view of American Management Association “Corporate governance is about how suppliers of capital get managers to return profits, make sure managers do not misuse the capital by investing in bad projects, and how shareholders and creditors monitor managers.” International Chamber of Commerce defines “Corporate governance as the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations.”

According to NACD Blue Ribbon Commission on Directors Professionalism Report (2005) “Corporate governance refers to how a corporation is governed. Who has the authority to make decisions for a corporation within what guidelines? This is the corporation’s governance. In the United States, the governance of corporations is largely determined by state laws of incorporation. State laws typically say that each corporation must be "managed by or under the direction of its boards of directors." More specifically, corporate boards of directors are responsible for certain decisions on behalf of the corporation. At a minimum, as stated in most state statutes of incorporation, director approval is usually required for amending corporation bylaws, issuing shares, or declaring dividends. Also, the board alone can recommend that shareholders vote to amend articles of incorporation, dissolve the corporation, or sell the corporation. No other person or entity except the board can take these actions. That is why discussions of "corporate governance" often focus on boards.” "Corporate governance is not an abstract goal, but exists to serve corporate purposes by providing a structure within which stockholders, directors and management can pursue most effectively the objectives of the corporation." – US Business Round Table White Paper on Corporate Governance September 1997.

The corporate governance practices in India can be well understood with the help of theories of corporate governance. There are two prominent

theories of corporate governance. They are: Agency theory and Stake holder theory

According to this theory as corporate are invisible units they have to be managed with help of agents, who on behalf of a principal (corporate) manage the affairs. Because of this concept, it is treated that these companies are extended partnerships. The principal (business) delegates to the agent to carry all or majority of the powers, on their behalf to manage the affairs of the business. The relationship of agent and principal is observed in managing the affairs of such corporate bodies. In about 18th century Adam Smit rightly commented in his "The wealth of Nations" with the following remarks:

"The directors (agent) of such companies however being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance which the partners in private coparceners frequently watch over their own…negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."

These remarks are quite noteworthy for growing necessity of better form of business, and accordingly these drawbacks given roots for the emergency of another form of business.

The pitfalls of agency form are eliminated to a great extent in this new form of business. The major premise of this theory is that shareholders manage the affairs of corporate with the help of board governors, who are appointed or nominated by them. The new form has the following features: Limited Liability; Perpetual Succession; Common Seal and Individual Identity (Business Entity).

All these features aimed at strengthen the real owners (shareholders), to carry the business with structure of board of directors in the form trust

and trustee relationship. Though the stakeholder theory appears to be good but it has lot of loopholes and consequently necessitating a good governance of corporate in a better form.

The above system of business is quite common throughout the world with certain minor divergence according to the requirements of a country's economic system. In India in contrast to other countries of the west, the corporate are run on the following patterns: (i) Completely under the control of the Government; (ii) Partially under the control of Government and (iii) No control by the Government.

In other sense these are based on the share holding pattern of the Govt. and Private in the concerned corporate. This is because of the economic system of India. The economy of the India runs on three patterns: mixed economic system; capitalistic economic system and socialistic economic system.

Basing on these three systems, the corporate are divided into a wide variety of forms. Some of the business forms according to the above pattern are: Sole Trading Form; Partnership Form; Company Form.

The majority of Indian corporate focus on the following activities. They are:

- Composition of Board Members
- Majority and Minority Voting rights
- Matters which concerns both Board of Directors and Shareholders
- Maintenance of Registers and Records as per law
- Submission of Annual Returns on time
- Certifications and Signatures from the certifying authorities
- Adherence to various laws and regulations

These practices can be treated as most common activities of Indian corporate, while doing these activities much focus will be given to internal

environment only, however, there is much scope to consider even external environment as well. It is worthwhile to consider the external environment, which is the vital factor for Indian's corporate governance. Some of the corporate governance practices culminated out of external environment are as follows: Clause 49 listing agreement; Disclosure of Director's interest; Formulation Whistle Blower Policy.

Research Studies:

Cadbury, Sir Adrian (1992) submitted a report on Corporate governance popularly known as Cadbury Committee's report, which found a major corporate governance difference between countries is the board structure, which may be unitary or dual depending on the country. As in the UK, in the majority of EU Member States, the Unitary board structure is predominant (in five states, the dual structure is also available). However, in Austria, Germany, the Netherlands, and Denmark, the dual structure is predominant. In the dual structure, employees may have representation on the supervisory board (as in Germany) but this may vary from country to country.

Greenbury, Sir R (1995) popularly known as Greenbury's report discussed about how much disclosure there should be of directors' remuneration and how useful detailed disclosures might be. The Greenbury report, issued in the UK in 1995, was established on the initiative of the CBI because of public concern about directors' remuneration.

Donaldson, L. and Davis, J.H. (1919) advocated various theories of Corporate Governance. The development of Corporate Governance is a global occurrence and, as such, is a complex area including legal, cultural, ownership, and other structural differences. Therefore some theories may be more appropriate and relevant to some countries than others, or more relevant at different times depending on what stage an individual country, or group of countries, is at or may have.

The agency relationship has been described as a "contract under which one or more persons (principal(s)) engage another person (agent) to perform some service on their behalf which involves delegating authority to the agent.

Some of the clearest evidence on agency problems comes from acquisition announcements. Many studies show that bidder returns on the announcement of acquisitions are often negative (Roll surveys this evidence). Lewellen, Loderer, and Rosenfeld find that negative returns are most common for bidders in which their managers hold little equity, suggesting that agency problems can be ameliorated with incentives. Morck, Shleifer, and Vishny find that bidder returns tend to be the lowest when bidders diversify or when they buy rapidly growing firms. Lang and Stulz find related evidence of adverse effects of diversification on company valuation. Diversification and growth are among the most commonly cited managerial, as opposed to shareholder, objectives.

Committees:

With the formation of corporate form of organizations, the frame work of corporate governance got wide recognition and quite peculiarly it was prevalent in various manifestations throughout the world. The theme of Corporate Governance has got recognition due to the constitution and formation of various committees and formulation of various laws throughout the world.

With respect to India, after the economic initiatives in 1991, the Govt. of India thought it fit to respond to the developments taking placing the world over and accordingly the initiatives recommended by Cadbury Committee Report got prominence. In order to give due prominence Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted committees to recommend initiatives in Corporate Governance.

The report of various committees helped a lot to streamline the corporate throughout the world. Some of the Committees with its formation is given under the following table.

TABLE: COMMITTEES ON CORPORATE GOVERNANCE

S. No.	Committee	Country	Date of Submission
1.	Cadbury	England	1992
2.	King Committee	South of Africa	1994 & 2002
3.	CII	India	1996
4.	Hampel	England	1998
5.	Kumar Mangalam Birla	India	2000
6.	SEBI	India	2000
7.	Narayana Murty	India	2003

However with respect to India, the recommendations of Naresh Chandra Committee, Dr. J. J. Irani Committee constituted by Ministry of Corporate Affairs, the Kumar Mangalam Birla Committee and N. R. Narayana Murthy Committee constituted by SEBI are more prominent. Apart from these committees, there are OECD principles and reviews by various other corporate bodies like FICCI, KPMG, ICSI etc. on the corporate governance practices in India.

Need for the Study:

The studies on corporate governance have been conducted at different places by several researcher all over the globe. Most of the studies covered the issues relating to committees, boards, functioning of boards, the role of the CEOs, audit committees and independent directors, etc in different industries. The studies on paper industry in India have not been conducted by any researcher so far. This study is intended to attempt on corporate governance in paper industry with reference to Indian economy. The conceptual issues, the recommendations of committees, measurement and

perceptions of employees and customers have been covered. These issues deserve a focus to understand corporate governance practices in paper industry and the sustainability of the industry. The effectiveness of the governance is based on implementation of the suggestions outlines.

Objectives of the Study:

(a) To review research and littérateur on corporate governance.

(b) To examine the committees constituted on corporate governance and their observations.

(c) To analyze corporate governance practices in selected paper mills.

(d) To examine in detail corporate governance practices in JK Paper Mill.

(e) To offer suggestions for effective corporate governance.

Research Methodology:

The present study is a culmination of both secondary and primary sources of data.

The researcher has visited various libraries and research centres in India and collected secondary data. Some of the centres are: Government of India Publications at Planning Commission Library, National Productivity Council, Sri Ram Centre for IR and HR, IPE library and other libraries in Visakhapatnam, Hyderabad and New Delhi.

The secondary sources of data collection included in the data available in the public domain for each of the corporate organizations as stated in the eleven paper industries collected through Cross-company Compilation. These include annual reports, sustainability reports, triple bottom line reports, company websites, special analysts' documents, press releases, company newsletters and other published and unpublished information available. A care with respect to the sample size is taken that all the units are listed companies as per the Indian stock exchange and accordingly eligible for study. The primary data in the form of field visits, observations

and questionnaires are used in select paper industry to confirm whether or not Corporate Governance Practices are followed in managing their units.

The study has been conducted with a questionnaire through personal interaction. Qualitative inputs were gained through personal interaction with 50 top management executives from the 12 paper industries for obtaining relevant inputs. Details regarding the philosophy, approach and actual implementation of initiatives with respect to corporate governance in each of these organizations were elicited.

Presentation of the study:

The study is presented in six chapters.

Chapter – 1 deals with Introduction, Methodology, objectives and Need of the study

Chapter – 2 explains Review of Literature

Chapter – 3 discuses Summary of various Corporate Governance Reports and Recommendations on Corporate Governance

Chapter – 4 explains Profiles and Analyses Corporate Governance Practices in Sample Organizations

Chapter – 5 analyses of Corporate Governance Practices in Paper Industry with a Case Study on JK Paper Mills

Chapter – 6 explains Summary and Suggestions of the study.